

**ST. PAUL'S SCHOOL**  
**GOVERNANCE RECOMMENDATIONS**

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I have been asked by the New Hampshire Attorney General's Office to review the governance structure of St. Paul's School, Concord, New Hampshire and to make recommendations I deem appropriate to strengthen that structure. My charge was to formulate recommendations independently of any views and opinions the Attorney General's Office may have either on the current governance structure of the School or what the governance structure should be. Thus, my recommendations are my own and are not derived from any instruction, direction or mandate imposed or suggested by that office.

My recommendations are based on my thirty years of extensive experience with nonprofit organizations at the Connecticut Attorney General's Office. As the attorney in charge of that office's Public Charities Unit, I routinely consulted with nonprofits on a wide range of governance and management issues. I had more than ample opportunity to observe nonprofit boards and why they succeed, fail, or all too often, suddenly become engulfed in financial and programmatic controversy that the board members never saw coming.

I was a founding member of the National Association of State Charity Officials and served three times as its President. In 1998, 1999 and again in 2001, I was named by *The NonProfit Times* as one of the fifty most influential people in the country with respect to nonprofit matters. I have served on a number of advisory boards to national standard setters, including the Internal Revenue Service, the Better Business Bureau Wise Giving Alliance and the Financial Accounting Standards Board.

I recently joined the law firm of Wiggin and Dana, LLP as counsel in its Tax-Exempt Organizations Practice Group. The firm has approximately 155 attorneys with

offices in New Haven, Hartford, Stamford, New York City and Philadelphia. My engagement with the New Hampshire Attorney General's Office commenced prior to my joining Wiggin and Dana and remains completely independent of the firm. Wiggin and Dana is aware of my engagement but there is no attorney-client relationship between the firm and the New Hampshire Attorney General's Office. As a precaution, prior to my joining the firm, Wiggin and Dana performed a conflicts check and found that none exist.

The recommendations that follow are derived from my own experiences and an extensive review of the literature on nonprofit governance, with particular attention to the growing volume of commentary on emerging trends and best practices. I have not commented or made recommendations on all possible governance issues, as I believe it is unnecessary. I have instead simply concentrated on areas in which I see an opportunity for St. Paul's to strengthen its governance structure.

A key point is that the experiences of some publicly traded companies and their auditing firms, the details and unfortunate effects of which are well known, have influenced the shifting paradigm in nonprofit governance. Publicly traded businesses and nonprofit organizations are not so fundamentally different as to preclude parallels between the two. Both have constituencies upon whom they depend and whose trust and confidence they must cultivate and preserve. Though the Sarbanes-Oxley legislation that emanated from the business controversies does not generally apply to nonprofits, expert commentary and recent developments make clear that the requirements of that legislation are being drawn upon as nonprofit institutions rethink and transform their governance structures from what has been to what should be. For example, last year Drexel University adopted broad governance reforms. The following is an excerpt from the University's announcement:

"We are not a public corporation, but we do the public's business," said Drexel Board Chairman C.R. "Chuck" Penmoni. "We have always aspired to conduct the affairs of this University at the highest levels of ethics, integrity and accountability. The actions we have taken today are a formal commitment to ensure that the best practices used by business will be applied by this University."

Three additional points are important to consider:

- Analysis of board structure is not about assessing the passion, sincerity and dedication of board members. Rather, it is about determining whether the governance structure supports and encourages the qualities that individual board members bring to the table. It is about looking for checks and balances and the prudent allocation of authority.
- It is ill advised to equate legal compliance with best practices. The interests of nonprofit institutions are best served by looking beyond simple compliance with the law. If poor governance structure and oversight creates conditions that allow the actions of a board to be called into question, it will be of little solace to disaffected constituents that the board complied with the law.
- A board should resist the temptation to only measure itself against what may be common practice at some similar institutions. A premier institution will seek to align itself with evolving thinking and adopt changes that will make its governance fundamentally sound.

The governance expert retained by the School and I have shared our recommendations with each other. I am pleased that we are in agreement on several measures the board can take to strengthen its governance structure, though significant differences remain.

### **RECOMMENDATIONS**

1. The bylaws should require the existence of the following standing committees: (i) an Investment Committee, (ii) a separate Finance Committee, (iii) a Nominating/Governance Committee and (iv) an Audit Committee. The duties and responsibilities of each of those committees should be set forth in the bylaws.

2. The Board should approve the composition of each of those committees, with the Executive Committee having the authority to fill vacancies that may occur between Board meetings.
3. The Investment Committee should establish investment policy, select and periodically review the performance of the Investment Manager(s) and receive periodic reports from the Treasurer on investment performance, asset allocation and related issues.
4. The Treasurer may be a member of the Investment Committee, but not its chair. The duties of the Treasurer shall be limited to implementing, in cooperation with School staff, the policies and decisions of the Investment Committee.
5. The Finance Committee should, among other duties of a Finance Committee, recommend a budget for Board approval and, in consultation with the Investment Committee, set the School's spending policy. The Treasurer may be a member of this committee but not its chair. The committee should also review the School's financial position on a periodic basis and act on any matters of concern.
6. The Nominating/Governance Committee, in addition to the role of nominating candidates for the Board, should be responsible for reviewing and evaluating on an on-going basis the governance structure of the School and its effectiveness, in light of best practices as they evolve in the nonprofit field. The committee should recommend to the Board structural and procedural changes with respect to the Board and management, as necessary. This committee, in cooperation with the Audit Committee, should also create and submit for the Board's approval an Ethics Code for School Board members, administration, faculty and other employees, including a procedure whereby any employee, volunteer, or any person doing business with the School can and is encouraged to bring ethical or legal issues, including accounting or financial irregularities, to the Board's attention with absolute assurance of confidentiality. The Code should be crafted in such a fashion that it makes clear the Board is setting a tone for exemplary ethics throughout the entire corporation and all persons who do business with the corporation.

Whistleblower protection policy and procedures should be clearly communicated to all such persons, including being set forth in the employee manual.

7. The Audit Committee.

(a) This Committee should select the auditor and establish the auditor's compensation. The committee should receive, discuss and approve the audited financial statements, the auditor's report thereon and the IRS Form 990. It should evaluate on an on-going basis the efficiency of the School's internal financial controls. The Treasurer shall not serve on this Committee. At least one member of the Audit Committee should be a financial expert in the field of not-for-profit education. This committee should meet at least twice each year, with adequate time to review all pertinent information prior to each meeting and adequate time to prepare a report to the full Board prior to its meeting.

(b) The selected auditor should be prohibited from providing non-auditing services contemporaneously with the audit. The Audit Committee should approve all non-auditing services. Preferably, the School should periodically rotate auditing firms. At a minimum, the lead audit partner and lead review partner should be rotated off the engagement after five years. Furthermore, the committee should be prohibited from hiring an auditor if any of the School's senior management was employed by the auditing firm and participated in any capacity in the audit of the School within one year before the initiation of the audit.

(c) The Rector and the CFO should certify to the Audit Committee that the financial statements are presented fairly in all material aspects and that there are no known significant control deficiencies or fraud that have not been addressed and resolved.

(d) The Audit Committee should assure itself that proper guidelines are in place and followed with respect to the use of the Rector's Discretionary Fund and any similar funds.

8. All members of each of the foregoing four committees should be independent. That is, they, their spouses, siblings, parents, children, and grandchildren shall not be, or have during the last three years been, employed by the School in any capacity (including the Rector), by any entity in which the School has a financial interest, or by any entity doing business with the School. Neither should any member of the four committees be paid for providing consulting or other services to the School.

9. Board member terms should be no more than three years.

10. No member should serve more than three consecutive terms. This includes *ex officio* members, such as President of the Alumni Association. There should be no exception to this provision such as is contained in the current bylaws. Time served completing the unexpired portion of a term of a Board member who has resigned shall not be considered a term, provided that the service is immediately prior to that person's election to a first full term.

11. A member who has served three consecutive terms, or who has resigned before completing a full term, should not be eligible for re-election for three years.

12. The above provisions should apply to any current Board member as if they were in effect on the date when the member was first elected to the Board. This means that some Trustees will be ineligible to continue to serve as such. However, in the interest of Board stability, a transitional rule should be crafted.

13. Officers of the Board (President, Clerk, Treasurer and others that may be created) should serve no more than two-year terms. They may be re-elected but shall serve not more than three consecutive terms in total. This rule should apply to any current officer

as if it were in effect on the date when the officer was first elected. Again, however, a transitional rule should be crafted if this provision would render a sitting officer ineligible to continue serving as such.

14. The bylaws should provide that a Board member will be removed if deemed unfit to serve by a majority of the members of the Board. The bylaws should also provide that the President will suspend an unfit Board member pending a vote of the full Board.

15. The bylaws should require the Board to annually evaluate the Rector. The Board should annually establish appropriate goals for the Rector against which performance will be measured. Moreover, ethics-related criteria should be included in the Rector's performance evaluation as well as in management's review of employees.

16. The bylaws should require that the Board conduct a self-evaluation at least bi-annually, including the functioning of all committees.

17. The Board should adopt a written policy setting forth standards for document integrity, retention and destruction.

Respectfully submitted,

David E. Ormstedt